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An analysis of accrual accounting and cost-based budgeting with applications in the Atomic Energy Commission and Department of Defense.

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AN ANALYSIS OF
ACCRUAL ACCOUNTING AND COST-BASED BUDGETING
WITH APPLICATIONS IN THE
ATOMIC ENERGY COMMISSION AND DEPARTMENT OF DEFENSE

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INTRODUCTION

Financial management processes such as budget formulation, appropriation procedures, and control of revenues and expenditures have been fundamental to the operations of the Federal Government since its inception. Problems associated with balancing the budget, reconciling costs and expending within allotments have caused much acrimony among the various agencies.

The financial management processes of the Government have been under constant surveillance by Congress and many new laws have been enacted in an attempt to improve these procedures. Despite the enactment of this legislation, a sound financial management program remains an elusive goal. With the advent of the New Frontier, additional steps have been taken and revisions instituted to correct some of the anomalies that exist within the framework of the present financial management structure. With the continual expansion of governmental operations, and the resultant need for efficient controls, it may be expected that attempts to resolve the enigmas of the Federal accounting processes will remain in the forefront.

It is the purpose of this paper to discuss two of the more recent attempts to revise the financial management procedures—Accrual Accounting and Cost-Based Budgeting. This paper will present a brief history and description of accrual accounting and cost-based budgeting,

and will discuss its implementation on a broad scale in certain illustrative specific applications.

It is hoped that this discussion of these measures of improved financial management will provide further understanding of the enormous and complex problems with which they are designed to cope.

I

HISTORY

Subsequent to the Treasury Act of 1789, which provided for an auditor and a comptroller in the Department of the Treasury for the purpose of controlling expenditure of public funds, the Congress has faithfully made periodic attempts to enact progressive legislation which would create better control over expenditure of public funds. Two acts of significance were the Dockery Act of 1894, and the Budget and Accounting Act of 1921. The latter, of course, is the most important, primarily because it established our national budget system by creating the Bureau of the Budget, administered by a director responsible only to the President. It also established the General Accounting Office under the administration of the Comptroller General.

The next important enactment was Executive Order 8248 in 1939 which transferred the Bureau of the Budget from the Treasury Department to the Executive Office of the President. This order evolved as a result of the findings of the Brookings Institution which, in effect, said: (1) the present system fails to provide the President with satisfactory budgetary management; (2) Congress does not have complete control of the collection, custody, and disbursement of public money, and (3) there is presently unnecessary delay in liquidation of obligations and the final settlement of accounts.

Other legislation of lesser importance, and a myriad of changes enacted by Congress, altered the budget process prior to the creation of the First Hoover Commission on July 7, 1947. Created by Public Law 162, 80th Congress, the First Commission expired on June 12, 1949.

The First Hoover Commission concerned itself primarily with the structural reorganization of the government departments, agencies, and bureaus and their relationship with each other. To improve the budget process, the First Hoover Commission recommended the use of performance budgets, clarified the authority of the President to spend less than the amounts appropriated by Congress if congressional purposes are carried out, and approved other recommendations of lesser importance. The First Hoover Commission also gave approval to one of its task force recommendations for the use of accrual accounting in the budget process.

Concomitantly with the hearings of the First Hoover Commission, the Joint Program to Improve Accounting in the Federal Government was initiated. The Joint Program to Improve Accounting in the Federal Government grew out of joint discussions among the Comptroller General of the United States, the Secretary of the Treasury, and the Director of the Bureau of the Budget as to the needs and problems of the Government for more effective and economical financial management practices.

Two of the main objectives of the Joint Program to Improve Accounting were:

> 1. Establishment of effective agency accounting systems on an accrual basis to the fullest extent this accounting basis is appropriate.
> 2. Establishment of cost-based budgeting practice effectively integrated with the accounts to provide adequate support for budget requests.[1]

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[1]Secretary of Treasury 1958, <u>The Joint Program to Improve Accounting in the Federal Government</u> (Tenth Annual Progress Report), p. 4.

Following the First Hoover Commission, in the period 1949-1951, several other important laws were enacted, notably the Budget and Accounting Act of 1950, approved September 12, 1950 (Public Law 784, 81st Congress.) This was the first comprehensive law covering budgeting, accounting, auditing, and reporting since the Budget and Accounting Act of 1921. The new law (1) provided for including in the Budget information on the functions and activities of the Government and other desirable classification of data; (2) strengthened the Bureau of the Budget in connection with its responsibilities for improvement of management throughout the executive branch; (3) defined the respective responsibilities of the General Accounting Office, the Treasury Department, and each executive agency in the accounting and reporting functions of the government, and (4) restated the responsibility of the General Accounting Office for auditing the activities of government agencies, and authorized such audits to be made at the site of agency operations with due regard to generally accepted principles of accounting.[2]

The list of all other legislation enacted between 1949 and 1950, which affected the future course of budget and accounting improvement, is as follows:

1. Public Law 216, 81st Congress, which was primarily concerned with establishment of uniform budgetary and fiscal procedures.
2. Public Law 152, 81st Congress which attempted to simplify the procurement, utilization, and disposal of Government property, and to reorganize certain agencies.

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[2] Ibid., p. 6.

3. Public Law 712, 81st Congress, which provided procedures for financial improvement of Post Offices.
4. Chapte XI of the General Appropriation Act, 1951, which strengthened control over obligations and expenditures incurred.[3]

From the aforementioned it can be seen that the departments, agencies, and Congress recognized the need for continuous financial improvement to keep pace with the changing times and economy. In the ensuing years, other legislation was enacted, specifically to implement the recommendations of the Second Hoover Commission.

The Second Hoover Commission was created pursuant to Public Law 108, 83rd Congress, on July 10, 1953, and expired in September, 1955. The Commission's report contained twenty-five recommendations related to budgeting, financing, accounting, reporting, and auditing practices of the government. Many of these recommendations were incorporated in Public Law 863, 84th Congress, which was approved on August 1, 1956.

Public Law 84-863 did not contain any new concepts of accounting. There were no new magic formulas. Many of its provisions were being accomplished administratively within the framework of existing statutes. The statement of W. J. McNeil, Assistant Secretary, Department of Defense (Comptroller), pointed this out in the subcommittee hearings on the proposed legislation, when he stated:

> This bill covers many recommendations in the Hoover Commission Report. Most of the proposed provisions are administrative matters which could be handled without legislation, although, I think we all agree, when enunciated in the law, may have an important effect on expediting desirable improvements.[4]

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[3] _Ibid._, p. 7.

[4] U.S., Congress, Senate, Committee on Government Operations. _Hearings on S. 3199, a bill to improve governmental budgeting & accountin methods and procedures_, 84th Congress, 2nd Sess., 1956, p. 161.

In essence, Public Law 84-863 was a congressional manifestation of the significantly needed changes to governmental accounting systems. Public Law 84-863 made the following mandatory for all agencies: (1) agency accounts shall be maintained on the accrual basis of accounting, and (2) agencies shall use cost-based budgets in support of appropriation requests and for internal agency administration and operation purposes.[5]

There were many other provisions, but these two are the areas of interest in this paper. Implementation of these two by all agencies would assist greatly in accomplishment of a third desire or recommendation of the Hoover Commission, namely, that there should be, insofar as possible, consistency in the accounting and budgeting classifications and practices of each agency.

In reviewing the history of accrual accounting and cost-based budgeting it is difficult to give credit to a specific impetus for their birth. Perhaps it was during the Roosevelt era, with expansion of deficit spending, but most assuredly the need for innovation was recognized during World War II, and even more so with its culmination.

Briefly, the second World War had a revolutionary effect on the American economy and on public finance. In a comparatively brief period a nation, seemingly unable to solve the unemployment problem of the Hoover and Roosevelt era, was operating at forced draft. Under the impetus of wartime demands, Federal expenditures rose from approximately nine billion dollars in 1940 to a peak of almost one hundred billion dollars in 1945. In the same period Federal revenues rose from five billion dollars to forty-five billion dollars. When the war ended in

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[5]Public Law 863, 84th Congress, Chapter 814, 2nd Session, S. 3897.

1945, the Federal debt exceeded two hundred fifty billion dollars, or approximately six times the Federal debt of 1940. This astronomical debt, plus the fear of a postwar recession, brought a keen awareness to the Congress of its obligations to the people in regards to the country's fiscal policy.

In the first postwar budget message [January 14, 1946], President Truman reflected the Government's concern when he indicated a desire for prosperity through private enterprise with the Government assisting as necessary, primarily through different approaches to Government spending in relation to the Federal Budget.

World War II experience in Federal finance pointed up the need for new and improved machinery for the Executive Office of the President, Congress, and the Federal departments in handling their financial problems. The major impetus for establishment of the Hoover Commission on the executive branch of the Government was the budget problem. A major product of the First Hoover Commission was the Budget and Accounting Procedures Act of 1950. This provided a basis for implementing the Hoover Commission's recommendations that the budget be in terms of performance, i.e., functions and activities, in addition to the classification of programs by departments and agencies.

The study by the Hoover Commission indicated that the fiscal policies and procedures of Federal Government were obsolete. The Hoover Commission pointed out that the present system was expensive, costs were obfuscated, and there was duplication of effort and fiscal controls. It also showed that neither the agencies nor Congress received adequate information from the existing system in regard to back-up data in the requests for budget appropriations.

To further substantiate the need for improvement, the task force report submitted by John W. Hanes to the chairman, Herbert Hoover, stated:

> The shortcomings of the Government's accounting are traceable directly to inadequate statutory provisions for the accounting function. One of the most serious results of these deficiencies is that the accounting is not integrated. In spite of much duplication of account-keeping, a complete set of books is not kept anywhere. Consequently, there is no place in the Government where the whole financial picture can be seen. Another result is that some of the accounts are not kept in accordance with principles whose observance would assure the recording of all essential information. Still another is that the accounts do not afford a ready basis for the preparation of complete, conclusive, and understandable financial reports.[6]

From the foregoing historical data, it is clear that the Federal accounting system at the time of enactment of Public Law 84-863 did not meet the needs of the Government. If annual obligations total $80 billion, and if annual carryovers total approximately $70 billion, and there is not a complete set of books within the Government, a revision of governmental accounting procedures seems necessary.

The new system should be maintained in such a manner that the accounts would be kept so they would show currently, fully, and clearly the sources of the funds, and for what purposes the funds are spent. The accounts should also reflect the total actual cost per year in terms of goods and services utilized, rather than those obligated. Specifically, accounts should be maintained on the accrual system, which is provided for in Public Law 84-863. The accrual system of accounting and

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[6] The Commission on Organization of the Executive Branch of the Government, Task Force Report on Fiscal Budgeting and Accounting Activities, (Washington: U.S. Government Printing Office, January, 1949), (Appendix F), p. 89.

cost-based budgeting would allow agencies to relate their cost to their obligations. This would enable agencies to account for unused resources and carry over, and thus would definitely result in better financial management.

II

ACCRUAL AND COST-BASED ACCOUNTING DEFINED

General

Public Law 84-863 provides that as soon as practicable after its enactment all agencies would shift to the accrual system of accounting. Agency accounts would reflect currently, completely, and clearly the receipt of goods and services, and the consumption or use of resources, reflect assets and liabilities, and the cost of operations of the agencies. In addition, in order to facilitate budget preparation, the accrual system would enable reconciliation of cost to expenditures and relate both to obligations. This is a test of a true accrual accounting system.

In contrast to the traditional obligational system of accounting, the accrual system provides more information in regards to funds on hand, inventories available, actual expenditures, etc. Also, cost data on the use of resources which are essential to agency management and for effective budgeting practices, are easily determined by the use of accrual accounting. Under the old system, agency budgets were prepared on the basis of estimated obligations to be incurred during the budget year. This method is simply an educated guess of expected obligations. The obligations for orders placed, contracts awarded, and similar transactions requiring a future payment of money do not necessarily have any relation to cost during a budget year. The old system

fails to take into account capital carry-over per year (about $70 billion), and fails to consider Government property and inventories totaling approximately 250 billion dollars.

By using the accrual system of accounting which incorporates broad account controls, each agency would keep and maintain expenditure accounts, accounts payables, receipt accounts, property accounts, accounts receivable, depreciation accounts, inventory accounts, and any other accounts as needed to provide sound financial management and supporting data for cost-based budgeting.

Public Law 84-863 also directs the agencies to prepare their budget requests in terms of costs; therefore, accrual accounting is a necessity and is tied to cost-based budgeting.

Bureau of the Budget Circular A-11 indicates that a cost-based budget relates work completed and future work plans to cost in terms of resources consumed, or in case of a procurement program to items procured or produced. A cost-based budget identifies resources on hand which are available, the value of goods and services ordered but not on hand, and total obligations required for the program.

Utilization of cost-based budgeting and accrual accounting means that it will be possible for the Government to determine at any given time its financial status. A budget using accrual data provides the most accurate measure of the cost of preceding periods. Therefore, accrual accounting and cost-based budgeting would provide the most complete disclosure of the Government's financial position, thus giving Congress a complete and adequate picture for review and analysis purposes of budget requests for appropriations. This method is far superior to the traditional method.

The foregoing has been an attempt to broadly define accrual accounting and cost-based budgeting. Several references were made to the traditional system without defining the traditional system per se. The traditional approach is to account to Congress for appropriations on the basis of obligations and expenditures. This is necessary to assure that sufficient appropriations are available at all times to cover the financial obligations incurred by the agencies in execution of their programs. As goods or services are ordered, an obligation is recorded against the appropriation. This obligation is liquidated when an expenditure is made and recorded, as when payment is made for the goods or services acquired. The traditional budget practice was to estimate the total expected obligations needed to execute functional programs within a budget year. This is a direct relationship between budgeting and accounting and is adequate for certain agencies, but falls short of the standards and procedures recommended by the Hoover Commission. The recording of obligations and expenditures does not reveal a story of accomplishments for a budget year. It does not indicate, for example, actual functional program costs per year in terms of operating expenses, nor does it indicate the portion of capital expenditures which represent work completed during the budget year. This is achieved by the introduction of accrual accounting and cost-based performance budgeting.

Nature of Accrual Accounting

Under the accrual basis, income is taken into account when it is earned, and expenditures are taken into account when they are made; costs are allocated to the programs as they are incurred. Thus, to

state it simply, when accrual accounting is used in the Government, revenues are taken into account or recorded on the books and put under control when they are assessed or otherwise formally established, and expenses are taken into account or recorded on the books as they are incurred, that is, when goods or services are obligated, irrespective of whether or not they have been received. Further, if something purchased is not immediately consumed when it is received, it is generally placed into inventory and further accounting becomes necessary. To illustrate, if supplies are purchased which may last for several years, program cost is not incurred at the time that the supplies are received, but later as they are consumed. For example, if several years' supply of a material is purchased and received during one fiscal year but is not completely consumed until the next fiscal year, it would be incorrect to charge all of the cost of the material as expense of the year in which it is purchased and received. Under the accrual system, the cost would be allocated to the year in which the material was actually consumed. Further, through the use of subsidiary accounts, the cost would be further allocated, or channeled to the specific functional program in which the material was actually used. This is the basis for accrual of cost data. Such an accrual basis for keeping accounts separates expenses actually incurred during the period from funds for expenses of prior or subsequent periods. The cost-based budget is derived from these accrued data.

Benefits Derived from Accrual Accounting

The basic objective of accrual accounting is better financial control through the development of more accurate and meaningful data on the assets, liabilities, costs, revenues, and expenditure of the agencies. This information would necessarily give Congress better control when reviewing appropriation requests.

Agencies have found that the additional information developed in an accrual system on the receipt of goods and services and on the use of resources is valuable for evaluating performance, financial planning, control of cost of operations, and for the development of budgetary requirements. Accrual accounting provides more effective control because it provides operating officials with data on all available resources and actual costs of program performance during a given period. Using accrual accounting, program costs can be analyzed and readily compared with planned forecasts or previous program costs. This was not so easy under the old system. An accrual accounting system furnishes the most complete disclosure of the costs of agency programs and their financial status, including undelivered orders, inventories on hand, and other resources available for such programs. Thus, it provides the best basis for determining and evaluating the financing requirements of planned programs.

Advantages of Accrual Accounting

The advantages of accrual accounting are many. A few of these advantages are as follows:

1. Indicates more accurately the costs of each activity over the year.

2. Accounts for sums obligated and spent and permits full disclosure of the financial results.

3. Provides accurate data for future budget formulation.

4. Provides better estimates for appropriation review by Congress.

5. Provides a means of testing the efficiency of the agencies and a means of assessing the results of their respective programs.

6. Provides adequate financial information needed for the agency's management.

7. Provides effective control over and accountability for all funds, property, other assets, and liabilities for which the agency is responsible.

8. Provides reliable accounting results to serve as the basis for preparation and support of the agency's budget request, for controlling the execution of its budget, and for providing financial information required by the Bureau of the Budget.

9. Provides suitable integration of the accounting of the agency with the central accounting and reporting responsibilities of the Secretary of the Treasury.

Nature of Cost-Performance Budgeting

In essence, cost-performance budgeting is comprised of two parts, performance and cost.

Performance (or Program) Budgeting recognizes the value of budgeting (and accrual accounting) in terms of distinct functional programs, each of which has some measurable end product. Thus, performance budgeting focuses attention on the program work to be undertaken and that which is to be accomplished; also it relates each functional program to all other functional programs insofar as its contribution to the total agency objective is concerned.

Cost Budgeting recognizes the value of budgeting (and accrual accounting) in the terms of the cost of goods and services consumed in the conduct of each of the functional programs established under the performance budget, irrespective of when the goods or services are ordered, paid for, or received. Thus, attention is focused on the actual cost of the work completed. These costs are reconciled in total to the amount of obligational authority required by estimating the change in unused resources which will take place during the year. Cost budgeting is in contrast to obligational type budgeting wherein estimates reflect obligations for orders placed, rather than the cost of goods or services consumed, and are classified according to the object involved (payrolls, transportation, supplies), rather than the functional program in which the object will be used.

A cost-based system shows separately those financial transactions which do relate to program performance during a time period. For example, program costs may be categorized to include:

(1) worth of material and other supplies actually used

(2) depreciation of plant, machinery and other facilities in use

(3) amount of wages earned by the employees

Program costs do not include:

(1) worth of material and other supplies which are in inventory or on order

(2) value of machines and equipment on order

(3) amounts of wages not earned by employees

In this simple illustration, the use of cost would enable the agency to determine the actual value of the goods or services which were used in producing the finished product. It is understood, of course, that the other material on hand is another form of asset, and those goods on order are accounts payable, both of which are accounted for under the accrual system but which have no bearing on cost-based budgeting. Inventory aquisitions or items on order have no effect on program performance or unit costs.

The cost-based budget provides Congress with additional information to determine the validity of appropriation requests by the agencies. The agencies have an improved basis for determining the validity of expenditure estimates in relation to their functional programs, and have an improved basis as back-up data for their appropriation requests.

Under Cost-Based Budget	Under Obligational Budget
1. Program cost consists of the value of goods and services used during the year.	1. Program costs consist of the value of orders for goods and services whether they will or will not be used during the year.
2. Excludes resources available for application at some future date, i.e., items on inventories and those on order.	2. Review of the programs by agencies must also consider future performance to the extent orders must be placed during the year.
3. Budget estimates are based upon past year cost, and can be directly related to the past year functional programs.	3. The need for funds for future performance cannot easily be considered separately from performance for the budget year.
4. Accounting on the accrual basis for depreciation, etc., provides information which is necessary to a determination of prices and fees for the sale of goods and services on a full cost basis.	4. Budget estimates are based upon experience data which are not necessarily related to work experience.
5. Free property transferred in or out can be reflected.	5. There is no accounting for depreciation, therefore costs can be obtained only by special analysis.
6. For those accounts receiving revenues, accrued costs may be directly related to accrued revenues. This provides for a better evaluation of future needs.	6. Free property and services are not reflected in the agency accounts.
7. Prepaid expenses are separated from functional program costs.[1]	7. Accrued revenues and accrued costs are not available.
	8. Information on prepaid expenses is not available, except by special analysis.

[1]U.S. Bureau of Budget, Discussion of the Cost Based Budget, pp. 14, 37, 1960.

Application by the Agencies

Public Law 84-863 specifically requires that each executive agency develop accrual accounting as soon as practicable. The degree to which the accrual basis is applied within the various agencies will vary with the nature of its operations and the needs of its management for accrual or cost information. The objective is to initiate accrual accounting in those agencies where its use will provide more useful and additional information, and where it will provide a better disclosure of the status and operational results of the agency. This is envisioned to encompass all agencies; therefore there are no exemptions from accrual accounting, but there is a recognition of a need for varying degrees of application in individual agencies.

In regard to the use of cost-based budgeting, Public Law 84-863 requires that requests for appropriations shall be presented on a cost basis in such manner and at such times as determined by the President, and that such cost-based budgets shall be used by all agencies for administration and operation. These requirements contemplate the development of cost of performance data for internal management and appropriation purposes, because such data provide the most realistic basis for financial planning and control decisions relating to the assigned operations of each agency. Agency internal operating budgets and appropriation requests must therefore be converted to a cost basis.

III

POLICIES AND PROCEDURES PRESCRIBED FOR AGENCIES

The history of the use of accrual accounting and cost-based budgeting has thus far been covered briefly. This section will trace how recommendations concerning accrual accounting and cost-based budgeting presented in the Second Hoover Commission Report were put into effect by government agencies.

Presidential Approval of the Bureau of the Budget's Plans

The first series of steps in putting these recommendations into effect involved an exchange of correspondence between President Dwight D. Eisenhower and Percival F. Brundage, Director of the Bureau of the Budget. On April 23, 1956, Mr. Brundage sent a letter to the President for the purpose of transmitting the Bureau of the Budget's "Analysis of the Bureau and Accounting Report of the Commission on Organization of the Executive Branch of the Government." This analysis states:

> The installation of accrual accounting systems has been a major objective of the Joint Accounting Program, which has made considerable progress in advancing the installation and use of such systems. A sizeable job still remains, but the development of accrual accounting throughout the Government will be given special and increased emphasis by the Bureau of the Budget and the Joint Accounting Program. Such

> systems are recognized as essential to the efforts that will be made to carry out the Hoover Commission's proposal for developing budgets on a cost basis.[1]

Included in the analysis of the recommendation that agency budgets be formulated and administered on a cost basis, it was further stated:

> Agency accounting systems are not, of course, overhauled overnight but as soon as accounting systems are producing the necessary data on a fully reliable basis, proposals for incorporating cost data in the Budget Document can and will be made to the Appropriations Committees.[2]

As shown by the above excerpts, the Bureau of the Budget recognized that there was a big job ahead in implementing accrual accounting and cost-based budgeting and that considerable time was needed to carry out these Hoover Commission recommendations.

The President, in his letter of April 26, 1956 to Mr. Brundage, approved of the plans of the Bureau of the Budget to accelerate the establishment and use of accrual accounting and cost-based budgeting in government agencies.

Bureau of the Budget Guidance

Following the passage of Public Law 863 of the 84th Congress on August 1, 1956, the Bureau of the Budget issued Bulletin No. 57-5 on October 10, 1956, to establish general requirements for the developmen

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[1] Enclosure to letter from Percival F. Brundage, Director of the Bureau of the Budget, to President Dwight D. Eisenhower, April 23, 1956.

[2] *Ibid.*

by each agency in the executive branch of a planned program for the implementation of accrual accounting and cost-based budgeting. In this bulletin the head of each executive agency was directed to submit a time schedule for the conversion of accounts to the accrual basis and the development of cost-based budgeting practices. Attached to this bulletin was the pamphlet, "Improvement of Financial Management in the Federal Government," which was provided as a guide for agencies in planning the program to implement the requirements of Public Law 84-863. The agencies were further informed that a review of their program would be held, after submission, by members of the Bureau of the Budget, General Accounting Office, and the Treasury Department with agency officials concerned with financial management to insure adherence to, and conformity with, the pertinent laws and instructions. Thus, with Bulletin 57-5 the Bureau of the Budget, on the President's behalf, exercised the leadership within the executive branch in carrying out the requirements of Public Law 84-863.

The Bureau of the Budget in succeeding years maintained its leadership role by describing how cost-based budgets were to be presented in Circular A-11, and by annually reviewing the status of improvement efforts by the individual agencies. In Bulletins 59-2, 59-9, 60-7, and 61-11 the Bureau of the Budget called for an agency report on the progress and future plans of installing accrual accounting and cost-based budgeting. (See Exhibit I for format used in 1961.) This information is used annually to prepare a summary of the action taken by the agencies in response to the Bureau of the Budget Bulletin 57-5 in the <u>Annual Progress Report of the Joint Financial Management Improvement Program</u>.

EXHIBIT I

Financial Management Improvement Program	Agency ________________
Agency Report as of June 30, 1961	Date ________________

Part A - Accomplishments and Future Plans

1961 Accomplishments

Future Plans and Schedule

Part B - Status Information

Organization and/or Accounting Equity	Accounting System			Cost-based Budgeting	
	Accrual Basis	Approved by Comp. Gen.	Submission for Approval	Used internally	Budget Presentation

Remarks

It has been shown that the Bureau of the Budget is the directing hand in insuring that government agencies carry out the requirements of Public Law 84-863. Now for a view of how the government agencies are to implement accrual accounting and cost-based budgeting.

General Accounting Office Guidance

Public Law 84-863 provides that the conversion of an agency accounting system to the accrual basis shall be taken in accordance with principles and standards prescribed by the Comptroller General, with a view to facilitating the preparation of cost-based budgets. The Comptroller General has recorded these standards and principles under Title 2 of the General Accounting Office Policy and Procedures Manual for Guidance of Federal Agencies, Volume I.

The following presentation reviews the theoretical aspect of accrual accounting and cost accounting as published by the General Accounting Office, the requirements of Public Law 84-863 concerning accrual accounting and cost-based budgets as interpreted by the General Accounting Office, an explanation of the difference between theory and law, and the progress made on converting accounting systems to accrual basis and budget presentations to cost basis in government agencies.

The General Accounting Office describes accrual accounting as follows:

> The accrual basis can be briefly characterized as an effort to reflect in the accounting records and financial reports events as they transpire from a time or period standpoint. For example . . . the accrual basis recognizes revenues when they are earned. . . . the accrual basis provides for recording the expenditure and a liability therefor when materials or services are received. Further, under the accrual basis the cost of

> materials is charged to expense in the period consumed (by use of an intervening account). . . . Similarly, in the case of fixed assets (plant, equipment, etc.) which ordinarily have useful life beyond the current period, the cost is spread over the periods benefitted under the accrual basis.[3]

A chart presentation of recording transactions under the accrual basis is shown below:

Transaction	Recorded in period in which-			
	Ordered	Received	Used	Paid
Placing an order for goods and services	As an obligation			
Receipt of goods and services		As an accrued expenditure		
Goods and services applied or consumed (actual performance)			As a cost	
Payments made				As an expenditure (disbursement)[4]

The Accounting Principles Memorandum No. 1 issued by the General Accounting Office on November 26, 1952 (revised September 18, 1957) describes the need for, the purposes and advantages of, and factors to be evaluated in an accrual accounting system. Throughout the memorandum the General Accounting Office emphasizes that when the accrual basis of accounting is used, a more accurate picture of

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[3] General Accounting Office Policy and Procedures Manual for Guidance of Federal Agencies, Title 2 (Washington: U. S. Government Printing Office, Revised 1961), p. 2-25.

[4] Ibid., p. 2-206.

financial conditions is presented. Because of this picture, the figures of governmental receipts and expenditures will be more meaningful and, thereby, more useful to management, the Congress, and the public. The General Accounting Office also makes it clear that

> . . . only under the accrual basis is it possible to arrive at the cost of goods sold or services rendered to be matched against the revenue earned therefrom during a given period.[5]

The General Accounting Office further states that:

> . . . the accrual basis of accounting should be used in each instance to the extent that accounting results will be significantly improved and thereby increase the value of accounting to management and others by 1) contributing to full disclosures, 2) improving financial control over assets and liabilities, 3) aiding in the development of cost accounting, 4) providing more informative budget data, and 5) furnishing more significant accounting data which is related to specific assignments of managerial responsibility.[6]

In its discussion on cost accounting the General Accounting Office also points out that accounting principles prescribe that cost accounting should be developed and used to the extent that the value of additional information made available outweighs the expensive added record keeping involved.

Therefore, it can be seen that the General Accounting Office recognizes that accounting principles dictate that accrual accounting _can_ be useful in financial management, but if the cost of such a system outweighs the benefits received from better accounting information, the system should not be put into effect.

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[5] _Ibid._, p. 2-26.

[6] _Ibid._, p. 2-39.

The requirements of Public Law 84-863 do not completely follow these principles. The General Accounting Office interpreted the requirements of this law in its "Accounting Principles Memorandum No. 3," dated October 18, 1957. The basic requirement is that all executive agencies must maintain their accounts on an accrual basis, or on a basis which can readily be converted to the accrual basis for purposes of cost-based budgets and other financial reports at all important reporting dates. An agency need not maintain its accounts on a continuous accrual basis if the information obtained from such accounting would not be significantly different from the information obtained from accounts maintained on an obligation or disbursement basis. Those accounts which are not maintained on a continuous accrual accounting basis should be converted at such time that the significance of such figures would be of beneficial use to top management officials and other review and appraisal groups and organizations. Any conversion adjustments resulting from periodical conversion should be recorded in the agency accounts so that the accounts will fully support the financial reports issued.

<u>Summary</u>

In review, it can be seen that the principles of accounting state that an accounting system should not be changed unless the benefits of such a change will be greater than the additional cost of the change. Public Law 84-863 is so drafted that the possibility of there existing areas where no benefits and only increased costs would result from using accrual accounting, was not taken into account. It appears that the General Accounting Office made an attempt partially

to correct this oversight by interpreting the law to mean that, in areas where continuous accrual accounting was not beneficial, accounts could be converted periodically to that basis. However, it is obvious that, based on accounting principles which the General Accounting Office recognizes, there could be situations where additional costs for unnecessary accounting are required by law.

The methods to be used in an acceptable accrual accounting system have been prescribed in the twelve chapters of illustrative accounting procedures in Title 2 of the General Accounting Office Policy and Procedures Manual for Guidance of Federal Agencies. These procedures are too extensive to summarize and include in this paper. Certain of these procedures, however, are identified in subsequent chapters dealing with individual agency implementation.

IV

STATUS OF GOVERNMENT-WIDE IMPLEMENTATION

The actual measure of the implementation of any legislative requirements should be based on the analysis of statistical data of the number of agencies which have adopted the requirements. In an effort to present the current facts about the implementation of accrual accounting and cost-based budgeting, information from The Joint Financial Management Improvement Program, Annual Report Fiscal Year 1960, and information from an interview with Mr. S. B. Savage, Associate Director of Accounting and Auditing Policy Staff of the General Accounting Office, have been combined in the following.

Since the General Accounting Office must approve an accounting system before it is considered to fulfill the requirements of Public Law 84-863, the report on implementation will be presented as seen by the General Accounting Office.

Approved Accounting Systems

In the civilian agencies—which number about 130—forty-one accrual accounting systems have been approved in their entirety by the Comptroller General. In addition, seventeen other systems have been partially approved. In the Department of Defense, only the Department of the Army Corps of Engineers' system has been approved in its entirety. Parts of other systems within the Department of

Defense have been approved in nine other instances. These figures are not very impressive and, furthermore, are misleading. The total of forty-two systems which have been completely approved is deceiving because they were approved by the Comptroller General as adequate in the light of legislation and conditions as they existed at the time of approval. This means that some of these systems would not be deemed adequate in the light of 1961 requirements. The number of inadequate systems is not available, but an indication might be postulated from the number of systems approved prior to the enactment of Public Law 84-863. Twenty-two such systems were approved prior to August, 1956.

There is no action presently planned for reviewing those systems that are inadequate by today's standards, which have been previously approved by the General Accounting Office. The General Accounting Office is presently more interested in reviewing and approving systems of those agencies which have never been approved. The General Accounting Office prefers to take this course of action, since it feels that the installation of approved accrual accounting systems is not proceeding fast enough.

The reason most frequently heard for not adopting accrual accounting is that there is extra cost involved without commensurate benefits. The General Accounting Office does not feel that accrual accounting, when properly maintained, creates an increased work load. The extra cost that agencies refer to stems from the idea that records presently being used for fund control will have to be maintained as well as the accrual accounting system. It has been found in those agencies that have accrual accounting systems which

have been approved by the General Accounting Office, that fund control need not be used at as low a level as it is under obligation accounting. Instead of allotments, operating budgets can be used at the lower level, and appropriation control as required by the Anti-Deficiency Act would be maintained at the upper level of the organization.

In an effort to make it clear that accrual accounting does not involve additional costs, the General Accounting Office has worked with various agencies to develop an accrual accounting system with the required fund control. This, however, has been a slow and tedious process, and the General Accounting Office feels that the requirements of the law are not being carried out as rapidly as desired. In order to reach more agencies with specific information about the benefits of accrual accounting, the General Accounting Office plans to distribute an illustration of how a system based on accrual accounting can be used for fund control. This illustration is expected to be released in February of 1962.

<u>Agency Reports of Implementation</u>

In the summary of "Agency Reports of Status" in <u>The Joint Financial Management Improvement Program, Annual Report Fiscal Year 1960</u>, 124 of the civilian executive agencies reported that they would have a complete accrual accounting system in effect by the end of 1961. In this summary 105 agencies reported that by the end of 1961 they would make their budget presentation on a cost-basis. It must be kept in mind that these figures reflect each agency's own evaluation of the degree to which it has attained accrual accounting and cost-based budgeting objectives, but do not signify that

the General Accounting Office, the Bureau of the Budget, or the Treasury Department agree with those representations. The General Accounting Office considers that many of these agency evaluations are being reported and published for "window dressing" purposes. Most of these budgets are not constructed from cost accounting data and are not used in any way for better financial management. They do not conform, except in the cases of those systems approved under present day requirements, with the law and are being submitted only to comply with the request of the Bureau of the Budget.

Department of Defense Status

In examining the summary it is seen that only the Department of Defense has reported as "indefinite" the expected date of implementation of accrual accounting and cost-based budgeting. Since the enactment of Public Law 84-863, the General Accounting Office and the Department of Defense have been in disagreement over the latter's partial disregard of the requirements of the law. The General Accounting Office is hopeful that the Department of Defense will make progress in converting to an accrual system as a result of its present review of accounting systems to support program package planning. The General Accounting Office has not been called in to assist in this review, but it has informed the Department of Defense that it will gladly provide any assistance desired. Since the Department of Defense expends the largest share of the Federal funds, the General Accounting Office would consider its implementation of accrual accounting to be a great asset in encouraging other government agencies to convert to accrual accounting.

Mr. Savage summarized the General Accounting Office's position as follows:

> Cost consciousness is the main benefit of accrual acounting. Obligation accounting does not provide the motivation for cost consciousness. Therefore, the General Accounting Office feels that Public Law 863 is a good law and that if the requirements are properly carried out, no additional costs will be incurred and a savings will be recognized by better financial management. The General Accounting Office is now actively attempting to enlighten agencies of the benefits of the system. Something has to be done to have the requirements of the law carried out at a more rapid pace and we think we are actively pursuing this end.[1]

Summary

A summary of the degree of implementation of accrual accounting and cost-based budgeting can be stated as follows:

> . . . in some of the agencies, the degree to which the modernized concepts have been applied does not appear to be adequate in relation to current requirements and objectives. In other cases, the agencies are still in the developmental stage of the program. Accordingly much still remains to be done before the ultimate objectives of the Joint Program are satisfactorily attained in all agencies throughout the Federal Government.[2]

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[1] Interview with S. B. Savage, Associate Director of Accounting and Auditing Policy Staff of the General Accounting Office, December 1, 1961.

[2] The Joint Financial Management Improvement Program, Annual Report Fiscal Year 1960 (Washington: U. S. Government Printing Office, 1960), p. 6.

V

APPLICATIONS WITHIN THE ATOMIC ENERGY COMMISSION

Selected Applications of Accrual Accounting and Cost-based Budgeting

Following the issuance of directives and guidance to the Federal agencies, there was a substantial effort on the part of the Federal agencies to comply with the letter, if not with the spirit, of Public Law 84-863. The significant questions that have to be asked, once an activity reports the development and execution of a program, are:

1. To what depth and in what areas is the change being implemented?
2. Is the reorganization of the accounting and budget structure anything more than a paper exercise to convey the impression of compliance with the law?
3. Will the revised system pay off in terms of more efficient management control and more efficient employment of government resources?

The partial answers to these questions can be obtained by an analysis of an agency's attempt to incorporate the legislated changes. No attempt can be made to evaluate the total government effort in a paper of this scope, but examples from selected analysis are appropriate. For these purposes, two agencies have been selected—the

Atomic Energy Commission [AEC], and the Department of Defense [DOD]. With respect to the latter, discussion will be limited to identification of directives of the Secretary of Defense, with particular analysis of the directives which apply to the area of appropriations for military construction.

Responsibilities and Programs of the Atomic Energy Commission

Under the law, the responsibilities of the Atomic Energy Commission are to:

> 1. Control possession, use, and production of atomic energy and special nuclear material so as to make the maximum contribution to the common defense and security, and to the national welfare.
>
> 2. Conduct, assist and foster research and development in order to encourage maximum scientific and industrial progress including the encouragement of widespread participation in the development and utilization of atomic energy for peaceful purposes.[1]

In order to carry out these responsibilities, major programs were established to:

> 1. Procure the necessary materials, principally uranium concentrate and ores;
>
> 2. Convert the uranium into special nuclear materials. . . . These special nuclear materials are the principle [sic] ingredients in atomic weapons and reactors;
>
> 3. Develop and fabricate nuclear weapons, that is, free falling bombs and missile warheads;

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[1]Presentation on AEC Financial Management given to the Bureau of the Budget in August, 1960, pp. 2-3. (in the files of the Commission.)

4. Develop nuclear reactors for a variety of purposes; . . . .

5. Conduct research in the physical and life sciences, particularly in the areas of special interest to atomic energy; and

6. Develop the application of radioactive isotopes and nuclear explosives to various segments of our civilian economy.[2]

These programs were organized into budget programs which have varied in number over the years but have been essentially the same as the following:

1. Raw materials
2. Special nuclear materials
3. Weapons
4. Reactor development
5. Physical research
6. Biology and medicine
7. Training, education, and information
8. Civilian applications of isotopes and nuclear explosives
9. Community
10. Administration
11. Security investigations[3]

The AEC is engaged essentially in industrial programs. The most significant portion of the work involved in carrying out these programs is performed by industrial concerns and universities under contract with the Commission for the operation of the government-owned facilities. To ensure sound financial management of such facilities and to permit flexibility of maintenance of integrated

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[2] *Ibid.*, p. 3.

[3] U.S., Bureau of the Budget, *The Budget of the United States Government for the Fiscal Year Ending June 30, 1962* (Washington: U.S. Government Printing Office, 1961), p. 119.

accounts, that is, accounts which will serve both the Government and the industrial contractor, a system of accrual accounting was considered imperative. This accounting system has to distinguish between assets, liabilities, income and expense, and provide functional cost breakdowns in sufficient detail to provide a tool for administration. Another determinant which influenced the organization of the Commission's accounting was the need for data to be used as a basis for:

1. Establishing charges for AEC products and services;

2. Appraising proposed capital plant improvements to determine pay out;

3. Appraising production efficiencies of the various Commission installations to determine distribution of production loads, and to indicate possible areas of management improvement; and

4. Assessing alternatives to direct government operations in meeting Commission requirements for products and services.[4]

Budgeting and Accounting

The AEC converted its accounting systems to an accrual basis in 1949. It submitted its first cost-performance budget to the Congress in 1950, covering the fiscal year 1951. A review of the preparation of budget estimates and budget administration is necessary to see how, utilizing the cost-performance concept, the budgeting is supported by an accrual accounting system.

Since 1953, Congress has provided funds for the AEC in two appropriations—one for Operating Expenses, and the other for Plant Acquisition and Construction. Accordingly, budget estimates are

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[4]Presentation on AEC Financial Management, op. cit., p. 7.

prepared in these two areas. Budget estimates may originate in the field (with the contractor or the AEC Operations Office) or at headquarters (with the Program Division, the General Manager or the Commission). The bulk of the budget estimates originate in the field. The budget for operating expenses is presented for each functional program in terms of accrued costs. Estimates are prepared on the basis of program costs and the necessary changes in selected resources. These would include inventories, accounts receivable and payable, and similar items. The total accrued cost is then reconciled to the total obligational authority through an entry reflecting these changes in selected resources. A planning estimate of the summary of operating costs by program reconciled to net obligations is presented in Table 1. The same data are presented in Table 2 in the form in which it was transmitted to Congress in the budget. Illustrative data are based on FY 1961 agency planning and budget submissions, as this was the latest available correlative data encompassing both. It is noted that the estimates for FY 1960 and 1961 were revised upwards when submitted to Congress, but for comparative purposes the FY 1959 data are the same in both Tables. Table 1 indicates an amount of $18,265,361.00 for changes in selected resources which, added to total accrued program costs, gives the total obligations for operating expenses. The breakdown in Table 2, from line 14 down, indicates how this figure was computed. The total program costs are compared with the accrued expenditures for the year. The difference between these two figures represents the costs for the current year which were financed from accrued expenditures of previous years. Table 3 breaks down this figure of the previous year's

TABLE I

SUMMARY OF OPERATING COSTS
BY PROGRAM RECONCILED TO NET OBLIGATIONS[a]
Atomic Energy Commission

	Actual FY 1959	Estimate FY 1960	Estimate FY 1961
Accrued costs by program:			
Raw materials	$ 705,512,144	$ 728,646,000	$ 630,000,000
Special nuclear materials	541,303,455	563,000,000	567,700,000
Weapons	484,879,166	498,100,000	504,000,000
Reactor development	347,057,273	389,800,000	436,200,000
Physical research	114,645,885	143,344,000	163,200,000
Biology and medicine	42,007,757	49,000,000	54,200,000
Training, education and information	13,033,893	13,500,000	14,200,000
Civilian applications of isotopes and nuclear explosives	5,762,397	11,000,000	11,500,000
Community	16,509,601	14,632,000	10,204,000
Program direction and administration	49,412,165	52,000,000	54,900,000
Security investigations	6,995,176	6,097,000	5,862,000
Other costs	5,559,672	5,800,000	6,500,000
Adjustment to prior-year costs	- 3,483,142	-0-	-0-
Total accrued program costs	2,329,195,442	2,474,919,000	2,458,466,000
Changes in selected resources	18,265,361	54,058,420	28,434,000
Total obligations for operating expenses	2,347,460,803	2,528,977,420	2,486,900,000
Less revenues applied	28,079,323	26,850,000	22,600,000
Net obligations (financed by appropriated funds)	2,319,381,480	2,502,127,420	2,464,300,000

[a]Presentation on AEC Financial Management given to the Bureau of the Budget in August, 1960. (in the files of the Commission).

TABLE 2

OPERATING EXPENSES[a]
Atomic Energy Commission
Program and Financing

Program by activities	1959 Actual	1960 Estimate	1961 Estimate
1. Raw Materials	$ 705,512,144	$ 733,646,000	$ 630,000,000
2. Special Nuclear Materials	541,303,455	563,000,000	567,700,000
3. Weapons	484,879,166	492,100,000	495,000,000
4. Reactor Development	347,057,273	402,400,000	436,200,000
5. Physical Research	114,645,885	147,644,000	158,900,000
6. Biology and Medicine	42,007,757	49,000,000	52,200,000
7. Training, Education, and Information	13,033,893	13,500,000	14,200,000
8. Civilian applications of isotopes development and nuclear explosives	5,762,397	12,000,000	12,500,000
9. Communities	16,059,601	14,632,000	10,204,000
10. Program direction and administration	49,412,165	52,000,000	54,900,000
11. Security investigations	6,995,176	6,097,000	5,862,000
12. Other Costs	5,559,672	5,800,000	6,500,000
13. Adjustment to prior year costs	- 3,483,142	- - - - -	- - - - -
Total Program Costs[1]	2,329,195,442	2,491,819,000	2,446,166,000
14. Relation of costs to accrued expenditures:			
Costs financed from accrued expenditures of other years, Net (-)	- 14,641,975	- 8,866,760	- - - - - -
Expenditures accrued for costs of other years, Net	- - - - - -	- - - - - -	20,029,000
Total Accrued Expenditures	2,314,553,467	2,482,952,240	2,466,195,000
Unpaid undelivered orders brought forward	-608,003,590	-641,038,142	-701,063,322
Adjustment of unpaid undelivered orders brought forward	- 127,216	- - - - - -	- - - - - -
Unpaid undelivered orders carried forward	641,038,142	701,063,322	707,768,322
Total Program (obligations)	2,347,460,803	2,542,977,420	2,472,900,000

[1]Includes capital outlay for equipment: 1959 $87,478,311; 1960 $93,358,000; 1961 $99,180,000.

[a]U.S. Bureau of the Budget, The Budget of the United States Government for the Fiscal Year Ending June 30, 1961 (Washington: U.S. Government Printing Office, 1961), p. 117.

TABLE 3

RELATION OF COSTS TO ACCRUED EXPENDITURES[a] AEC

	1959 Actual	1960 Estimate	1961 Estimate
Accrued resources at end of year:			
Inventories and items on order:			
Inventories of Atomic Energy Commission and integrated contractors (goods unconsumed by activities)	$ 191,790,775	$ 185,798,000	$ 182,307,000
Advances (payments for goods and services on order not yet received):			
To other Federal agencies	3,451,772	3,451,772	3,451,772
To non-integrated contractors	2,327,846	2,327,846	2,327,846
Prepaid Expenses of Atomic Energy Commission and integrated contractors:			
Payments for:			
Collateral funds and other deposits	20,693,649	20,684,000	20,684,000
Goods and services on order not yet received	22,592,611	19,728,275	43,248,275
Total accrued resources at end of year	240,856,653	231,989,893	252,018,893
Accrued resources at start of year (-)	- 255,498,628	- 240,856,653	- 231,989,893
Costs financed from accrued expenditures of other years, Net (-)	- 14,641,975	- 8,866,760	- - - - -
Expenditures accrued for costs of other years, Net	- - - - -	- - - - -	20,029,000

[a]U.S. Bureau of the Budget, The Budget of the United States Government for the Fiscal Year Ending June 30, 1961 (Washington: U. S. Government Printing Office, 1961), p. 119.

accrued expenditures which, it can be seen, is the change between the total of accrued resources——in this case a reduction——between the beginning of the year and the end of the year. Returning to Table 2, the data show that the accrued expenditures are then adjusted to incorporate the change in unpaid, undelivered orders during the year——which would be reflected in changes in receivables——to give the total of program obligations for the year.

The budget for Plant Acquisition and Construction, which in recent years has averaged about ten percent of the budget for operating expenses, deviates from the cost presentation for operating expenses in that it presents requirements in terms of obligations only for each functional program. The Commission feels that the significant feature for evaluation in this area is not the annual cost but the total cost. Accordingly, in the annual budget presentation, obligational requirements are highlighted. Data on cost progress by year for each construction project are maintained in the internal cost accounting system and are available to the review bodies.

The Financial Plan

Administration of the Commission's operating budget is accomplished by means of a financial plan. Like the budget, the financial plan is a statement of program costs, changes in selected resources and obligational authority. It sets forth both the planned cost for the year of each functional program, together with the remaining budget items which are necessary to reconcile costs with the total obligational authority required to carry out the entire plan. In summary, an over-all financial plan for the year is developed at

headquarters within the limits of funds appropriated. The over-all plan is broken down into individual plans for each operations office or headquarters division having direct operating responsibility for the execution of a program.

The plan for each office sets forth the annual cost ceilings for each of its programs, plus or minus the increase or decrease in selected resources. The program totals on the summary page of the financial plan are supported by detailed breakdowns. These indicate the estimated costs for each activity or function within each program. Each office receiving a financial plan distributes the costs for each activity by month in accordance with planned progress. This projection of costs, together with the monthly reporting of costs on a comparable basis, provides management with a tool for measuring performance. This system requires extensive presentation for full understanding but the attached charts present key, representative reporting forms utilized in administration of the plan. Table 4 is the yearly financial plan for a typical Operations Office for FY 1960. Table 5 is a sample of a monthly cost-budget report which relates the specific month's operations to the annual financial plan and serves to measure progress in terms of the yearly financial plan. Supplementing the other reports are monthly product unit cost reports which permit more detailed analysis of program deviations from planned objectives.

With regard to administration of contractor operations, final controls are exercised through the contract itself which sets the maximum amount to which the contractor can commit the Government during a specified period. The amount is recorded as an

TABLE 4

FINANCIAL PLAN[a]

APPROPRIATION: OPERATING EXPENSES
Atomic Energy Commission

Operations Office or Headquarters Division				Fiscal Year
Item	Current Plan	Increase or Decrease (-)	Proposed Plan	Approved Plan
1. Program Costs Incurred:				
A. Raw materials		+ 10,000	10,000	10,000
B. Special nuclear materials	1,879,000	- 20,000	1,859,000	1,859,000
C. Weapons				
D. Reactor development	18,675,000	+ 2,018,000	20,693,000	20,693,000
E. Physical research	31,969,000	+ 8,999,000	40,968,000	40,968,000
F. Biology and medicine	10,156,000	+ 249,000	10,405,000	10,405,000
G. Training, education, and information	320,000	+ 2,000	322,000	352,000
H. Isotope development	345,000	-0-	345,000	345,000
I. Civilian applications of nuclear explosives				
J. Community operations				
K. Program direction and administration	2,177,000	- 47,000	2,130,000	2,130,000
L. Security investigations				
M. Other costs	365,000	-0-	365,000	365,000
N. Total program costs	65,886,000	11,211,000	77,097,000	77,127,000
O. Less: Revenues	410,000	57,000	467,000	467,000
P. Net program costs	65,476,000	11,154,000	76,630,000	76,660,000
2. Increase or decrease in unapplied resources	-2,520,000	- 7,895,851	-10,415,851	-16,874,629
3. Appropriation reimbursement				
4. Reconciling transfers between AEC Offices	- 736,150	- 497,738	- 1,233,888	- 183,888
5. Transfer appropriation				
6. Planned obligations	62,219,850	2,760,411	64,980,261	59,601,483
7. Less: Amount not allotted				1,400,000*
8. Obligational authority allotted	62,219,850	2,760,411	64,980,261	58,201,483

Remarks:
* AEC reserve for Army Compact Reactor

[a] Presentation on AEC Financial Management given to the Bureau of the Budget in August, 1960. (in the files of the Commission).

TABLE 5

U. S. ATOMIC ENERGY COMMISSION[a]

OPERATIONS OFFICE ________

CONTRACTOR ________

DATE February 28, 1960

PART I OPERATIONS - FUND (in thousands)

Description	Classification Number	Current Month	Year to Date	Financial Plan Underrun (Overrun)	Financial Plan Fiscal Year 1960
Raw Materials	1000	1	6	-0-	10
Special nuclear materials	2000	43	467	232	1,859
Reactor development	4000	1,881	13,472	(1,563)	20,693
Physical research	5000	2,469	20,286	6,394	40,968
Biology & medicine	6000	819	6,649	60	10,405
Program direction	8000	177	1,402	(6)	2,130
Isotopes development	8600	22	231	(36)	345
Training, education and information	8700	36	314	(105)	352
Other costs	8900	144	892	(755)	365
Total operating costs		5,592	43,719	4,221	77,127
Revenues	10400		(1,547)		(467)
Net costs			42,172		76,660
Change in selected resources			3,211		(17,059)
AEC payments			45,383		
Change in unpaid obligations			(6,753)		
Obligations incurred			38,630		59,601

[a]Presentation on AEC Financial Management given to the Bureau of the Budget in August, 1960. (in the files of the Commission).

obligation on the Commission's books. This process is summarized as follows:

> The responsibility for maintaining such commitments within the limits set under the contract rests with the contractor. However, the contractors do budget and control in terms of cost elements, (labor, materials, burden, etc.) by cost centers (departmental and other organizational units), and distribute these costs to activities and functions in accordance with normal accounting procedures. . . . the contractors set up estimates on the basis of the organization, employment, materials, etc., necessary to carry out the program . . . . these follow industrial type budgets, with monthly reporting on the same basis . . . . Broadly speaking, the review and control of contractors' operations in terms of "cost elements" and "cost centers" is limited to the contractors' own management staffs and that of the Commission's office immediately responsible for the supervision of the contract.[5]

The above procedures are employed in accounting for the funds granted in the operating expense appropriations. However, funds granted under the Plant Acquisition and Construction appropriation are administered through obligation accounting. Most of the AEC's construction projects are let on fixed price contracts and funds for the entire project are normally appropriated in one year. Costs are used in the internal administration of the construction budget. Victor Corso, Deputy Assistant Controller for Budgets, AEC, summarizes this process as follows:

> We estimate the amount of cost that will be incurred in any given fiscal year and call for monthly projections of these costs, which should reflect the actual progress under a given construction project. When our monthly reports come in, the actual is compared with the projection. This flags areas where substantial deviations may signify

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[5] *Ibid.*, p. 18.

either trouble in meeting the targeted date of completion or inaccurate cost estimating.[6]

Evaluation

The foregoing demonstrates that the AEC functions are conducted and performance is measured in cost parameters and indices. This cost-based budget system is supported by the accrual accounting system which is required to provide, on a monthly basis, the cost status of the functional programs. This cost status has to incorporate data on the following:

1. What funds have been obligated?
2. Which of the obligated funds have been expended?
3. The cost of what goods and services which have been received have been paid for by which expenditures regardless in which fiscal year the expenditures were incurred?
4. What are the status and financial measure of inventories in both the Commission's and the contractors' hands?
5. What is the measure of goods and services which have been ordered and for which funds have been obligated, but which may not be provided for some time?

The logical question is what is the value of the accounting and budgeting systems of the AEC to its management function and, ultimately, to the taxpayers?

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[6] Victor Corso, "An Interagency Panel: Accrual Accounting and Cost Budgeting," The Federal Accountant, XI (December, 1961), p. 92.

James A. Miller, at the time Deputy Assistant Controller for Budgets, summarized the early development of the Commission's system, thus:

> It was soon evident that traditional allotment systems and reports on obligations and expenditures were not an adequate basis for financial control. . . . These problems of budget presentation and administration were due principally to the nature of the programs, the organization of the Commission, and its method of contracting . . . . the monthly trend in obligations and expenditures was of little or no value in measuring performance, evaluating the adequacy of funding, or determining the status of funds at any given time during the year.[7]

The logical solution was,

> . . . the development of a system based on control of programs through costs with a simplified allotment system to control obligations to the extent necessary to comply with laws and regulations regarding the expenditure of federal funds.[8]

Wayne R. Starr, Chief Budget Operations Branch, Office of the Controller, AEC, further summarized the value of the cost-based systems to the Commission. The Commission uses costs in three principal functions:

1. To establish comparisons between the cost of AEC produced power and commercial power produced from other energy sources.

2. To make efficiency comparisons among various contractors engaged in similar work for the Commission and among the different AEC activities.

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[7] James A. Miller, "A Cost-based Budget in an Agency," The Federal Accountant, IX (September, 1959), pp. 40-41.

[8] Ibid., p. 42.

3. As a measure of general performance in all areas of the organization.[9]

Under one and two above, it is noted that, in order to measure cost most accurately, the Commission includes plant and equipment depreciation in the computation of operating expenses. However, this is excluded in the computation of operating expenses included in the budget presentation.

Assuming the proposition that accrual accounting systems tend to cost more to maintain than the more simple obligation/expenditure accounting systems, there is some measure of economy in the integrated accounting system employed by the Commission and its industrial contractors. This economy is twofold: one, the number of accounts required to be kept can be, and by Commission testimony is, less than the number that would be maintained if the contractors were required to keep one complete set of accounts in one system and the Government another set in another system; two, there is an inherent economy achieved from the more facile inter-operations achieved out of employment of a common system. The Commission feels further that system economies are realized through not having to operate separate "industrial funds" which would entail additional accounting, and that accounting reports, based on arbitrary distributions and adjustments, are eliminated.[10]

Mr. Corso summarizes his defense of the Commission's system as follows:

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[9] Interview with Wayne R. Starr, Chief Budget Operations Branch, November 8, 1961.

[10] Miller, op. cit., p. 49.

These two financial systems, one for operations and one for construction projects, have been well received by management. They are understood by the Appropriations Committees. We think they meet some of the objectives the Hoover Commission had in mind in recommending accrual accounting and cost budgeting, particularly with respect to congressional control of the funding and level of operations of the Atomic Energy Commission.[11]

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[11] Corso, op. cit., p. 92.

VI

APPLICATIONS WITHIN THE DEPARTMENT OF DEFENSE

Department Directives

In contrast to the early action of the Atomic Energy Commission, whose financial management organization and reorganization had most often anticipated legislative or executive prescription, the Department of Defense [DOD] has been, perhaps, the slowest of the executive departments to respond to the congressionally willed reorganization of financial management systems. This fact is particularly significant in consideration of the percentage of the annually appropriated funds which the Department administers.

In reviewing what the Department of Defense has accomplished, at least in certain areas, it is necessary to review the organization of the Defense budget. This budget is under five budget titles, reflecting the five major areas of the defense program. These are:

Military Personnel

Operation and Maintenance

Procurement

Research, Development, Test and Evaluation

Military Construction

The DOD chose to initiate the implementation of the requirements of Public Law 84-863 by issuing directives covering each of these areas.

The first directive, Department of Defense Directive Number 7040.1, was issued May 29, 1959. It established policies for the development of planned programs for improvement of financial management in the area of appropriations for Operation and Maintenance. Although this directive prescribed that each military department should prepare its own manual implementing this instruction, the DOD subsequently issued a brochure titled <u>Production of Financial Reports for Appropriated Funds in the Department of Defense with Illustrations for the Area of Operation and Maintenance</u>. This brochure, commonly identified as the "Blue Book," was supplemented with a brochure titled <u>Bookkeeping for an Operating Unit.</u> Subsequently, a manual titled <u>Financial and Accounting Procedures in the Area of Appropriations for Military Construction</u> was issued in January, 1960. This manual is commonly referred to as the "Green Book." By some curious circumstance, the directive, which this manual was intended to amplify, (Department of Defense Directive Number 7040.2) was not issued until January 18, 1961. To date, these directives and implementing manuals comprise the total output of policy guidance issued by the Secretary of Defense.

Although issued at different times and differing in some phraseology, these directives derived from the same authority and prescribed a common set of policies, principles and procedures designed to effect common objectives through standardized methodology. In order to achieve a logical and sufficiently comprehensive presentation, the following will be confined to an analysis of the DOD program in the area of military construction. Any differences in the structure of the two aforementioned systems is considered due to functional differences in the areas in which

the systems are to be employed, not to any significant differences in the *modus operandi* prescribed. It is emphasized that the program outlined, inasmuch as it is to effect changes to operating systems, is presently--within the individual military departments--mostly in the planning stages.

Objectives of the Program

The basic objectives of the improvement in financial management are stated as follows:

> 1. Improved budgeting and justification of appropriation and apportionment requests, based upon coordinated planning and programming, through the use of information of costs of programs and activities appropriately classified to meet management requirements. . . .
>
> 2. Improved programming and justification of requests for Congressional authorization of the major construction programs, prior to and as a basis for appropriation requests, likewise based upon coordinated planning, programming and budgeting, through the use of information on costs of proposed programs. . . .
>
> 3. Improved administration and management of operational resources by responsible organizations within the Department of Defense through:
>
>   (a) Use of cost-based operating budgets and simplified, flexible, funding practices based upon such operating budgets.
>
>   (b) Use of reports on performance in terms of costs and related program data, especially in relation to operating budgets, and reports on the status of resources.[1]

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[1]U.S., Department of Defense Directive Number 7040.2, *Program for Improvement in Financial Management in the Area of Appropriations for Acquisition and Construction of Military Real Property* (Washington: Defense Printing Office, 1961), pp. 1-2.

Attainment of these objectives requires the implementation of plans for:

1. Use of cost-based budgets and programs to support authorization, appropriation and apportionment requests, and in the administration and management of the department. . . .

2. Support of program and budget justifications by information on proposed military construction in terms of cost by project and installation. . . .

3. Use of a consistent and integrated account structure for purposes of planning, programming, budgeting, and accounting (including reporting).

4. Making of administrative subdivisions of appropriations on the basis of cost-based budgets.

5. Simplification of administrative subdivisions of appropriations with the objective of financing each operating unit responsible for acquisition or construction from not more than one subdivision of funds for each appropriation affecting such unit.

6. Use of the accrual basis of accounting with financial accounting of property . . . as an integral part of the system.[2]

<u>Appropriations and Budgets in the Area of Military Construction</u>

To place in perspective the detailed structure being developed to implement the objectives noted above, it is necessary to review briefly the programs which are covered within the area of military construction and a few significant features of their administration. Projects covered in military construction programs include all acquisitions of land and acquisition or construction of real property facilities in excess of $25,000 for each project for the active forces and $10,000 for the Reserve Forces and National Guard. Minor construction projects of

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[2] *Ibid.*, pp. 2-3.

less than these amounts may also be included. It should be noted that certain types of construction can be accomplished with funds from appropriations other than the "Military Construction" appropriation, but this is not within the purview of this paper. The military construction command-management function is performed for all the military departments by two departmental operating agencies—the Army Corps of Engineers and the Navy Bureau of Yards and Docks. The funds, separately appropriated by Congress under the Military Construction title, are administered and accounted for by these two agencies. The ultimate objective of the DOD is to finance all costs of military construction, including planning, design and other construction overhead costs, under the appropriations for that purpose. To the extent that construction may be financed from other appropriations, cost-based programs and budgets should include these costs and show the amounts financed under other appropriations. Within the military construction appropriations structure, there is a uniform classification of budget programs which relate to the major subdivisions of the total construction program. Accounts are organized around these budget programs. These accounts are used to summarize costs and obligations in budgets and reports. These budget-program accounts are:

1. Major construction
2. Minor construction
3. Supporting programs
4. Reimbursable construction work
5. Supporting programs

In reviewing the basic objectives of the DOD financial management improvement program, the most significant changes are sought in

the budgeting area. Budgeting is considered all-inclusive and consists of:

1. Budgets required to support appropriation requests.
2. Budgets required for administrative management purposes in the budget execution process.

These are identified as "operating budgets."[3] The essential requirements are that all budgets shall be cost-based and shall be used at all levels of management as a means of coordinating programs with available resources. Budgets are to be characterized by the following insofar as the requirement is applicable to the scope of the budget:

1. Estimates supporting appropriation requests shall be in terms of cost to completion for major construction program projects, and on a lump sum basis for minor construction programs and supporting programs.

2. Estimates in operating budgets supporting apportionment and funding requests for all construction programs shall be in terms of cost to completion for each project or other prescribed account classification.

3. Within the budgets, obligations and accrued expenditures shall be accounted for in terms of the respective budget-program accounts and by installation or other work classification as may be established by legislative-authorization acts.

4. Within the budgets, reimbursements shall be estimated and accounted for in terms of reimbursements anticipated, orders received and reimbursements earned on work performed for, or services provided to others.

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[3] *Ibid.*, p. 6.

The Accounting Structure

Probably the most significant element of the records structure, which is to support cost-based budgeting and the total financial reporting system, is the organization of accounts. As conceived by departmental planners, the DOD accounting system should meet three objectives:

1. It should assure proper discharge of fiduciary responsibility by all accountable officers.

2. It should provide for administrative control of funds and be designed especially to prevent overexpenditure of appropriated funds.

3. It should provide for the necessary data for the exercise of managerial planning and control of programs or missions to which government agencies are assigned.

The system must be geared to function smoothly as a part of a broader financial system and at the same time be technically capable of rendering the services demanded of it. It should be consistent with the method of budgeting, the lines of budgetary control, and the funding procedures utilized. The system must be organized under the double-entry principle, that is, continuously equating the total resources available for obligating with the unpaid obligations, plus the unobligated balance. Most essential is that it be a single integrated system. To meet all these criteria, the accounts have been organized into three major groups—fund accounts, cost-and obligation accounts, and property accounts. A short analysis of each major group of accounts follows.

Fund Accounts

Fund accounts are used:

> . . . to classify, accumulate and serve as a source of reports for resources, unpaid obligations and unobligated balance of each appropriated fund, including any subdivision of it.[4]

The following is an illustration of accounts for an allotted fund which would be a subdivision of an appropriated fund for military construction managed by a district office:

Debits

Resources:
- Undisbursed Treasury balance
- Accounts receivable - reimbursements
- Accounts receivable - refunds
- Anticipated reimbursements to be earned
- Advances for travel
- Advances on contracts
- Undistributed expenditures

Credits

Unpaid Obligations:
- Accounts payable
- Accounts payable - withheld on contracts
- Accrued liabilities
- Contracts and orders outstanding

Unobligated Balance:
- Major construction
- Minor construction
- Miscellaneous activities construction
- Reimbursable construction
- Planning[5]

This account structure gives effect to the balance-sheet equation which can be demonstrated in several ways, some of which are:

$$\left[\text{Resources}\right] = \left[\begin{array}{l}\text{Unpaid}\\ \text{Obligations}\end{array}\right] + \left[\begin{array}{l}\text{Unobligated}\\ \text{Balance}\end{array}\right]$$

$$\left[\begin{array}{l}\text{Allotment}\\ \text{received}\end{array}\right] + \left[\begin{array}{l}\text{Reinbursements}\\ \text{earned or}\\ \text{anticipated}\end{array}\right] - \left[\begin{array}{l}\text{Obligations}\\ \text{incurred}\end{array}\right] = \left[\begin{array}{l}\text{Unobligated}\\ \text{balance}\end{array}\right]$$ [6]

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[4] U.S., Department of Defense, Financial and Accounting Procedures in the Area of Appropriations for Military Construction (Washington: U.S. Government Printing Office, 1960), p. 9-1.

[5] *Ibid.*, p. 9-2.

[6] *Ibid.*

As planned in the system, a separate set of fund accounts must be established for each allotted fund. However, a single allotted fund can serve all budget programs to the extent that they are financed from the same appropriated fund. Financial control over each program is exercized through establishing a separate unobligated balance account for each program through which the obligational limitation for each program can be controlled.

The major purpose of fund accounts is to set forth at all times the balance available for future obligation of each budgeted program. The managerial and control advantages of such a grouping are obvious. In addition, the procedure is considered simple and accurate in that it displays readily the relationship among the accounts.

Cost-and-Obligation Accounts

Cost-and-obligation accounts, in a sense, are self-explanatory. They serve to classify the purposes for which expenditures are made and obligations are incurred. While not organized as systematically as fund accounts, they are designed to afford maximum managerial control over costs.

A separate set of cost-and-obligation accounts is used for each budget program. Charges to cost and charges for obligations incurred are recorded as debits in the cost-and-obligation accounts. Charges to cost include the funded and unfunded costs. Unfunded costs are those which are financed from an appropriated fund other than for military construction. These must be segregated from funded costs in order that the funded costs may be accounted for as accrued expenditures in the fund ledger. Charges for obligations incurred include award of contracts and

issuance of orders. These eventually develop into funded costs as performance takes place.

The debit accounts are balanced with credit accounts in which these charges are recorded in the same terms found in the fund ledger, that is, as charges to the unobligated-balance account for the particular budget program.

As previously indicated, the cost-and-obligation accounts are more loosely structured than the fund accounts. It is essential that they be integrated with and support the fund accounts. As a support element, they provide the data for the accrued expenditures in the fund accounts. The cost-and-obligation accounts are commonly organized by installation but this is not universal. There are, additionally, cost-and-obligation accounts which are not structured to a particular budget program but, instead, cut across programs. Cost accounts for planning and overhead can be in this category.

Property Accounts

Within the Military Construction area, the chief purpose of property accounts is to keep a record of the Government's investment until the property is transferred, upon completion, to the user organization. These accounts are relatively few and are highly summarized. The data included in the property accounts come from the cost-and-obligation accounts which, in effect, are subsidiary accounts to the property accounts. By utilizing the cost-and-obligation accounts to the maximum, duplication is avoided and the property accounts can be kept to the minimum.

The following is the list of the basic property accounts:

	Debits
Major construction in progress	
Minor construction in progress	
Miscellaneous construction in progress	
Reimbursable construction in progress	
	Credits
Government's investment in construction in progress[7]	

A separate property-asset account is provided for each budget program for construction. Each account provides for all costs incurred on projects under the given program. Property accounts establish two important controls: one, a set of control figures over costs incurred for the construction, and two, a set of control figures over cost of completed construction projects. These figures are used by the user organization to whom the completed project is transferred to record the costs in its own property accounts.

As the total account system has been designed, there is a continuous linkage between funds allotted for construction, costs incurred to this end and cost of property emerging from the construction effort. By maintaining this interrelationship, each group of accounts plays a dual role. First of all, each group of accounts develops the data required for its own financial reports. Secondly, each group of accounts serves as a check on the accuracy and reliability of the other set of accounts.

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[7] *Ibid.*, p. 11-4.

The Report Structure

An essential characteristic of an accounting system is that it meets the requirements of the reporting system which is in effect throughout the organization of which it is a component. Within the DOD military construction area, the reporting system is planned to be structured in the same classifications as the accounts, that is, there are three basic reports which must originate at the operating levels. These are the Fund Report, the Cost-and-Obligation Report and the Property Report. A separate fund report will be prepared for each allotted fund for construction and will consist of four related statements as follows:

1. Statement of funds provided and obligated
2. Cumulative statement of obligations incurred
3. Statement of cash transactions
4. Statement of financial condition (fund balance sheet)[8]

The report on costs and obligations incurred has a separate section for each budget program. It is prepared monthly and annually. The property report gives a summary of the changes in the Government's investment in property for the period covered and will be prepared monthly or quarterly.

Evaluation of Implementation

In summary, in evaluating the Department of Defense implementation of the accrual accounting and cost-based budgeting requirements of Public Law 84-863, certain facts stand out. The Office of the Secretary

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[8] *Ibid.*, p. 12-5.

of Defense has developed a system of accounts and issued guidance thereon in two of the appropriation areas, as has just been discussed. However, the changes to the individual accounting systems of the many different operating activities of the three military departments to have them conform to the legislated requirements, vary substantially. Most of the activities had adopted modified accrual and cost accounting systems, at least in certain areas, over the past decade. Uniformity of systems, even within the military departments, has not been the byword, however. Only one military department accounting system has ever been approved by the General Accounting Office, that of the Army Corps of Engineers. It is significant that this was approved in 1955, prior to the enactment of Public Law 84-863. It is subject to re-evaluation.

For many reasons, therefore, the total response of the Defense Department to adoption of systems and changes to systems, in line with the currently advocated improvements in financial management, has been slow. These reasons cover the field from bureaucratic inertia and the size and complexity of the systems under consideration to the question of cost and, as an extension thereof, the question of whether any system modifications will pay off in long-run benefits. The Department of the Navy has been taking steps to implement the changes required by the DOD directives mentioned earlier. In the area of Operation and Maintenance, plans were drawn to shift to an accrual accounting system in early 1961, but action was deferred due to the costs that the change-over would entail. In the area of Military Construction, which this section has detailed, the Bureau of Yards and Docks had reorganized its

accounting system substantially in 1956. It adopted an accrual system built about an account structure similar to that prescribed in the DOD directives which have been discussed. However, substantial changes will still have to be effected to bring the system into total conformance. For example, the fund accounts are still maintained in a single entry system and would therefore have to be changed over to double entry. Action is being taken but the best estimate of full implementation of the system prescribed by the Secretary of Defense is about July, 1963.

The progress of the individual military department's implementing action is currently being influenced, of course, by the very pronounced fiscal and economic views of the Department of Defense new administration. The form of program budgeting espoused by Assistant Secretary of Defense, Charles J. Hitch, certainly is centered in cost concepts and would seem to require an integrated accrual accounting system to support it. In a speech delivered to the American Society of Military Comptrollers on September 21, 1961, Mr. Hitch stated:

> Obviously, we must continue to account for the use of funds in terms of appropriations. So, too, we must know the cost of resources consumed for activities within the appropriations. As I stated earlier, a well-rounded financial management system must fulfill all these requirements.

He stated further that a special study would be conducted on the accounting, information and reporting systems of the DOD. This study, as of the date of preparation of this paper, is still in progress. Whether this review will result in an accelerated implementation of changes along the lines of the existing directives which have been

discussed, or whether other innovations will be stressed, is a matter of speculation. The final determination of whether the Defense Department is progressing towards the goals of improved financial management, in conformity with the will of Congress as expressed in Public Law 84-863, will be made, of course, by the General Accounting Office.

VII

SUMMARY

The purpose of using accrual accounting and cost-based budgeting is to assist executives in gaining the benefits that result from better financial management. The task force on budgeting and accounting reported to the Hoover Commission that dollar savings of about $4 billion could reasonably be expected, if its recommendations, which included accrual accounting and cost-based budgeting, were put into effect in government agencies. A better understanding of what this dollar figure was meant to represent can be obtained from examining how it was reached.

It was not the intention of the committee to imply that $4 billion could be saved by simply changing the accounting methods. The quoted figure was given to insure that those reading the report would not minimize the effect that adoption of the twenty-five recommendations could make. The figure used was, in fact, very unscientifically determined. One of the experienced members of the task force, who was running a very large business, was asked:

> If in your business you did not know what you owed and couldn't tell what you had, . . . how much do you think it would be worth to you if you could suddenly come by that factual information?[1]

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[1]F. Harold Stewart, "The Hoover Commission Recommendations on Budgeting and Accounting," The Federal Accountant, March, 1958, p. 9.

From his answer it was determined that his business would never enter a project unless it could expect to save at least ten per cent. This figure was used to compute the savings on the $48 billion of controllable items in the budget at that time. The savings, by using this method, amounted to $4.8 billion, but so that it would not be accused of measuring precisely, the task force decided to say $4 billion. This figure, then, was intended to be a symbol, not an estimate, of the large amount of money that could be saved by better financial management, if all the recommendations were carried out.

Some critics of the requirements of the law have defended their position without making reference to the "mythical $4 billion." In the most recent issue of The Federal Accountant, such a dissenting opinion of the law was voiced.[2] The author's premise is that no one accounting system for all of industry is advocated by general accounting principles. Therefore, why should Congress dictate that such a universal accounting system must be used in the Federal Government? Because of this incongruity, it is felt that no successful system for the Federal Government that has uniform principles and procedures can be established for use in every Federal agency. In other words, it is unfortunate that we have the law in existence as it is presently written. This does not mean to say that there are no areas where accrual accounting and cost budgeting can be applied beneficially. These systems should be tailored to fit the particular program and not be forced upon

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[2] James F. Kelley, "A Critical Appraisal," The Federal Accountant, December, 1961, pp. 84-88.

agencies which will have no beneficial results from their use. When these systems are appropriately used for management purposes, management provides public services in the most efficient and economical manner. However, the resulting efficiency created does not result in Congress having better control of the pursestrings. It simply means that better use of the funds appropriated by Congress is made.

The General Accounting Office answers any accusation that it is trying to advocate one accounting system by pointing out that it does not prescribe specific accounting systems. It only restricts approval—which is required by law, if such a system is considered to fulfill the requirements of the law—to those systems that are considered adequate and in conformity with its general principles and standards.[3]

In conclusion, the requirements for accrual accounting and cost-based budgeting by Public Law 84-863 cannot be said to be all good or all bad. Government agencies readily admit that savings can be realized through good financial management. The critics of the law admit that there are areas where accrual accounting and cost-based budgeting can be applied beneficially. The main point of disagreement is the requirement that all agencies must adopt accrual accounting and cost-based budgeting.

Laws that require change when change is not needed should not be enacted. Congress, by approving Public Law 84-863, is guilty of this transgression. The law should be changed to read that accrual accounting

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[3]Ellsworth H. Morse, "Current Legislation and Accounting Principles," The Federal Accountant, March, 1958, pp. 18-19.

and cost-based budgeting should be instituted only in those agencies which, as a result of their use, benefit through better financial management. Such a change would result in agreement between the law and sound financial principles.

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